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To Repeal Or Not Repeal the Rule Against Perpetuities

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Issue Contents

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To Repeal Or Not Repeal the Rule Against Perpetuities

— by Neil E. Harl*

The new century is rapidly coming to be dominated by two developments—terrorism and the realization that the universal dismantling of important institutional structures can have devastating long-term consequences. The latter point has been dramatically made by the Enron debacle, the Andersen accounting fiasco, the Global Crossing bankruptcy, the Tyco problems and the general distrust at all levels of aggressive business strategies and tax shelter schemes. The message in all of this is critical: we should be very, very careful in dismantling important institutional constructs in the euphoria of the moment.

That is what makes the argument that states should repeal the Rule Against Perpetuities appear out of touch with reality.[1] Those urging repeal have dusted off the thread-bare and largely discredited arguments that the venerable Rule Against Perpetuities is no longer needed and should be jettisoned.

What the argument's all about

The basic issue is how long property can be tied up in trust. The Rule has come to stand for the proposition that interests in trust must vest, if at all, not later than 21 years after the last to die of a class of lives in being at the creation of the interest in trust.[2] As a practical matter, that has tended to impose a maximum term of 100 to 125 years for property to be held in trust.

Complete repeal of the Rule removes the limits on how long property can be held in trust.[3] With repeal, assets could be tied up 500 years, 1,000 years, indeed forever. Professor Lewis Simes, a well-known legal scholar of his era articulated two reasons for the Rule in contemporary society—

> "First, the Rule Against Perpetuities strikes a fair balance between the desires of members of the present generation, and similar desires of succeeding generations, to do what they wish with the property which they enjoy". In a sense this is a policy of alienability, but it is not alienability for productivity. It is alienability to enable people to do what they please at death with the property which they enjoy in life. As Kohler says in his treatise on the Philosophy of Law[4]—
>
> > 'The far-reaching hand of a testator who would force his will in distant future generations destroys the liberty of other individuals, and presumes to make rules for distant times.'"
> >
> > "But in my opinion, a second and even more important reason for the Rule is this. It is socially desirable that the wealth of the world be controlled by its living members and not by the dead. I know of no better statement of that doctrine than the language of Thomas Jefferson, contained in a letter to James Madison, when he said: 'The earth belongs always to the living generation. They may manage it then, and what proceeds from it, as they please during their usufruct.'"[5]

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To the above two reasons, a third can be added. It is an article of faith that economic growth is maximized if resources are subject to the forces and pressures of the market. Prices emanating from free, open and competitive markets are the best way to allocate resources and to distribute income if economic growth is to be maximized. Without question, repeal of the Rule would tend to insulate assets from the market. Over time, this could be a highly significant factor and would almost certainly slow economic growth. With the trust assets shielded from market forces, widespread ownership of assets in such dynasty trusts would almost certainly reduce the rate of economic growth. That could easily amount to 0.2 to 0.3 percent per year—with the damping effect possibly increasing over time.

For example, assume a couple with two children place $1,000,000 of property in trust in 2003. Further, assume the state in question is one of the dozen or so states that have repealed the Rule.[6] What could be the consequences of setting up the trust to last forever?

• Fast forwarding to 2503, 500 years from now, our two beneficiaries would have increased to 3.4 million (based on projections by the Joint Editorial Board for the Uniform Probate Code) assuming current fertility levels.

As the Joint Editorial Board for the Uniform Probate Code has stated—

> "Over time, the administration of such trusts is likely to become unwieldy and very costly.
>
> "Government statistics indicate that the average married couple has 2.1 children. Under this assumption, the average settlor will have more than 100 descendants (who are beneficiaries of the trust) 150 years after the trust is created, around 2500 beneficiaries 250 years after the trust is created and 45,000 beneficiaries 350 years after the trust is created. Five hundred years after the trust is created, the number of living beneficiaries could rise to an astounding 3.4 million."

And that's only 500 years. In 1,000 years, it would clearly be unmanageable.

As the period of trust life lengthens, with millions of trust beneficiaries, a situation would be created where trust-owned property would be perceived in a manner similar to government-owned property. It would resemble the way beneficiaries view the social security trust fund, for example.

• The trust, perhaps in 2003, would be administered in some place like Sioux Falls, South Dakota. But with the dramatic consolidation in banking and among trust companies, the trust might eventually be managed in Beijing or Jakarta or Hong Kong. Not everyone is comfortable with that.

• As the centuries pass, it would lead to enormous economic power in the hands of banks and trust companies. That is obvious, with beneficiaries limited in terms of their right to participate in management decisions. Remember, trusts are not like corporations with perpetual life where shareholders have and can (and do) exercise their rights.

Some argue that much of the family wealth is in 401(k) plans and IRAs and those are already managed by financial institutions. That is correct—but all qualified plans require a minimum distribution beginning after a beneficiary attains age 70 1/2.[7] Therefore, pension and profit sharing accounts *cannot* be held in economic hostage forever.

This country was not based on dynasties. Indeed, this country was founded, in part, on the notion of open access to assets, not on the idea that property owners could tie up property forever.

Part of the drive to repeal the Rule was based on the belief that the generation-skipping transfer tax is less advantageous when the Rule limits the period in which property can be placed in trust to lives in being plus 21 years.[8] Congress in 2001 repealed that tax, effective for deaths after 2009.[9] The combination of repeal of the generation-skipping transfer tax, repeal of the federal estate tax and repeal of the Rule Against Perpetuities would lead not only to dynasty trusts; it would lead to a separation of the legal ownership from equitable ownership of property to a degree we've never seen in this country.

In conclusion

The Rule Against Perpetuities was developed for good reason; those underpinnings to the Rule haven't changed in the centuries since the Rule was first articulated.

Many opponents of repeal are supportive of efforts to permit the reasonable accomplishment of educational and other objectives of property owners. Indeed, many are willing to lend support to proposals that would assure a trust duration of 150 years.[10] That should be long enough to permit rational planning even with regular increases in life expectancy for at least the next few years.

FOOTNOTES

[1] Duke of Norfolk's Case, 3 Ch. Cas. 1, 22 Eng. Rep. 931 (1682).

[2] See e.g., Iowa Code § 558.68(1) (2003).

[3] See Bloom, "How Federal Transfer Taxes Affect the Development of Property Law," 48 *Cleve. St. L. Rev*. 661 (2000); Anderson, "Ohio Joined the Dynasty Trust Parade: Should Your Clients?" 1 *Estate Tax Planning Advisor*, Issue 11 at 13 (2002).

[4] 12 *Modern Philosophy* 205 (1914).

[5] Simes, Lewis M., *Public Policy and the Dead Hand*, 58-59 (1955).

[6] Alaska Stat. §§ 34.27.010, 34.27.050, 34.27.051; Del. Code tit. 25, § 503(a) (as to personal property in trust); Me. Rev. Stat. Ann. tit. 33, § 101-A; N.J. Stat. Ann. §§ 46:2F-9, 46:2F-11; Ohio Rev. Code Ann. § 2131.09(B); R.I. Gen. Laws § 34-11-38; S.D. Cod. Laws Ann. §§ 43-5-1, 45-5-8; Va. Code Ann. §§ 55-12.1 to 55-12.6; Wis. Stat. Ann. § 700.16(5). See Idaho Code § 55-111 (unclear as to whether Rule completely repealed). See also Mo. Rev. Stat. § 442.555 (modified); Ill. Comp. Stat. Ann. §§ 765, 305/4, 305/5 (same); Md. Code Ann. § 11-102(e); Pa. Cons. Stat. tit. 20, § 6104 (modified); Wash. Rev. Code. Ann. § 11.98.130 (150-year period of validity).

[7] T.D. 8987, 67 Fed. Reg. 18,987, April 17, 2002.

[8] See Bloom, "The GST Tax Tail is Killing the Rule Against Perpetuities," 87 *Tax Notes* 569 (2000).

[9] EGTRRA of 2001, Sec. 501(a), (b), repealing I.R.C. §§ 2210, 2664. The provisions of EGTRRA of 2001 are subject to a "sunset" provision for decedents dying, gifts made and generation skipping transfers after December 31, 2010. EGTRRA of 2001, Sec. 901.

[10] See Wash. Rev. Code Ann. § 11.98.130 (150-year period of validity).